

Part I : The Experiences of Asian Developing Economies under Globalization: Institutional Reform and Industrial Restructuring : Chapter 3; The Case of Indonesia: 'Headed for Realignment of the Political Economic System'

journal or publication title	Development Strategies Toward the 21st Century
page range	71-90
year	2002
URL	<a href="http://hdl.handle.net/2344/00009884">http://hdl.handle.net/2344/00009884</a>

## **CHAPTER 3**

### **THE CASE OF INDONESIA: HEADED FOR REALIGNMENT OF THE POLITICAL ECONOMIC SYSTEM**

*Yuri Sato*

#### **Abstract**

Indonesia has gone through the most drastic changes in the political economic system among the Asian countries hit by the currency crisis. The reason is that the long reign of the Soeharto government collapsed amid the crisis and triggered the shift in the political setup from the authoritarian to democratic system. During the 1990s when globalization made headway, Indonesia moved to liberalize its economy and financial sector but its political system remained authoritarian. Under that authoritarian regime, the political power and big businesses in the private sector deepened alliance. Following the collapse of the Soeharto government, banks and corporations have undergone reconstruction, through which the alliance formed under the rule of President Soeharto was dismantled. Big private businesses that gained power during the Soeharto era are declining, and state and foreign capital is taking over to cause the fundamental change in the structure of ownership. Amid all this, a handful of big businesses in the private sector have achieved corporate restructuring on their own. In that sense, the crisis provided an opportunity for viable businesses to be screened by the yardstick of corporate capabilities. However, it remains to be seen whether Indonesia will be able to regain its competitiveness on the basis of corporate capabilities of private businesses that were able to survive restructuring and whether the governance of the government and corporations will be improved after economic reconstruction.

#### **1. INTRODUCTION**

It is often the case that the process of the reconstruction of the Indonesian economy after the Asian currency crisis is discussed along with Thailand, South Korea and other East Asian countries also hit by the crisis. But it has to

be noted that what happened in Indonesia in the crisis was the drastic shift of the political setup from the authoritarian to democratic system, not just a change of government as seen in Thailand or South Korea. In Indonesia, the currency crisis was the last chapter of the crisis of the Soeharto authoritarian rule, and the process of economic reconstruction forms a part of the historical process marked by the dismantling of the Soeharto regime and the search for a new democratic state system.

The 1990s that preceded the currency crisis had been a decade when economic globalization made progress and post-Cold War democratization became an international trend. Under the Soeharto's rule, Indonesia tried to deal with globalization in the economic sphere, but maintained the rigid authoritarian system politically. Indonesias responses in the 1990s thus differed from those of Thailand and South Korea, which undertook both political democratization and economic liberalization over a period of time. This difference seems to have been significantly affecting Indonesias response to the crisis as well as the process of the post-crisis economic reconstruction.

This paper sheds light on what changes Indonesias economic reconstruction has brought about, in the context of the globalization from the 1990s and the changeover of the political system amid the crisis. In the Section 2, Indonesias responses to the changes in the international environment in the 1990s are reviewed. Section 3 examines the post-crisis economic reconstruction, particularly how banks and corporations are being restructured and what structural changes the process is bringing about. Section 4 looks at institutional efforts aimed at improving the governance of the government and corporations, the very purpose of the country's economic restructuring. Then, in Section 5, the paper offers a summary conclusion and implications concerning the outlook for corporate reconstruction.

## **2. INTERNATIONAL TRENDS IN THE 1990S AND RESPONSES FROM THE SOEHARTO REGIME**

There were the two main factors of the international environment that had affected the Soeharto regime during the 1990s. The first was the end of the East-West Cold War structure in 1989. The threat of communism, the important factor behind the birth of the Soeharto government in 1966, disappeared on the international scene. Since then, democratization and respect for human rights became the dominant themes in the international society. Another was the trend toward the economic liberalization and market economy associated with the globalization of economic activities.

In connection with the international trend of democratization, the Soeharto government tried to impose the top-down democratization from 1989 through the mid-1990s, as calls mounted for the opening (*keterbukaan*) of political

discussions, a taboo in Indonesia for long, with the advancing age of President Soeharto, who turned 70 in 1991. Then U.S. Ambassador to Indonesia Wolfowitz encouraged the open debate, seeking a smooth change of government and the political opening. Confident of social control after completing the institutionalization of the authoritarian political system in 1985, President Soeharto eased its grip on speech and the press, and lifted the bans on workers strikes and political activities on the campus. This top-down democratization policy helped activate the mass media, workers, residents, students, and non-governmental organizations on human rights and environmental issues. However, as workers demonstrations turned violent and the press exposed feuds within the power elite, the government shifted gear and arrested and convicted labor movement leaders and also banned widely-read magazines. While the bottom-up democratization movements became active in response to the top-down democratization policy, the Soeharto regime turned its hand over and oppressed popular demands for political participation as soon as they transcended the permissible range. But the blunt oppression after the pendulum swung to the opening only made the public become keenly aware of the authoritarianism of the regime. The friction between the regime and the society eventually led to the reform (reformasi) movement that brought down the Soeharto government after the currency crisis.

Meanwhile, the Indonesian economy was in the sustained boom period since the late 1980s, together with the economies of neighboring Southeast Asian countries. In tandem with the international trend of economic globalization and liberalization, activities of Indonesian companies showed some signs of globalization in fund raising and overseas investment. Seeking funds at lower cost, more and more companies took in overseas borrowings and CP (commercial paper) issuing. Some companies deposited funds raised overseas with banks in the same business groups to be used for investment in new businesses by affiliated companies. Several major business groups expanded overseas, doing business in Hong Kong, China, ASEAN countries and other area.

Major economic policies in this period were economic liberalization and private capital utilization. Under the liberalization policy, trade and investment deregulation made progress, including tariff reductions and the abolition of restrictions on foreign capital. Furthermore, drastic financial liberalization was enforced in 1988, resulting in the rush of new bank establishments and exchange listings of companies. In the area of private capital utilization, private companies were encouraged to enter public works projects like the construction of expressways and ports and laying of telephone lines, until then the preserves for state enterprises, under the BOT (build, operate and transfer) formula.

The important thing, however, was that the liberalization and private-capital utilization policies did not necessarily bring about the market mechanism-

based efficient resource allocation as textbooks taught. On the contrary, the policies became a fountainhead of lucrative concessions to be allocated to specific companies. A good example was privatization projects. In many cases, companies that won project contracts were not selected in open tender. Even when a tender was held, a winning bidder was chosen according to the intentions of a government agency of jurisdiction and President Soeharto who controlled it. Another example was protective measures on midstream and upstream sectors. When a downstream sector of a given industry was liberalized with tariff cuts, it was often coupled with protective measures for the midstream and upstream sectors for import substitution. Such protective measures were not limited to higher tariffs on intermediate products and raw materials, but included steps to limit the production or import of intermediate goods and materials to one or just a few licensed companies. These methods were frequently used for such industry as petrochemicals and steel.

In the allocation of concessions such as contracts for privatization projects and exclusive production and import licenses, pribumi (native Malays that account for over 95% of Indonesia's population) businessmen were evidently favored since the late 1980s over Chinese established businessmen more suited to respond to globalization. Heading the list of pribumi businessmen were children and relatives of President Soeharto, including his eldest daughter Siti Hardijanti Rukmana (commonly known as Tutut), an owner of business group named Citra Lamtoro Gung Group, and his third son Hutomo Mandala Putra (commonly known as Tommy), an owner of Humpuss Group. It became the regular practice for state-owned banks to provide massive loans to these specific businessmen, virtually with no proper screening, when they needed investment fund to take advantage of the concessions they acquired. Thus, behind the policies of economic liberalization, market economy and private capital utilization, the Indonesian economy was usurped by the concession businesses of the specific businessmen and the deepening alliance, so-called KKN (Korupsi, Kolusi dan Nepotisme, or corruption, collusion and nepotism) among the power elite, bureaucrats and businessmen.

### **3. RECONSTRUCTION OF BANKS AND CORPORATIONS**

In Indonesia, the currency crisis developed into the political crisis and even into the broader social economic crisis. By the collapse of the Soeharto government in May 1998, the country's currency, the rupiah, tumbled by up to 80% from the pre-crisis value. The corporate sector, hit hard by the swelling burdens of repaying dollar-denominated debts, sharp rises in import prices and contraction of domestic demand, became unable to service debts owed to domestic as well as international creditors. Banks too became insolvent, as

deteriorating financial conditions of borrower companies increased nonperforming loans and the high interest rate policy to defend the rupiah, which jacked up interest rates to 80% a year, undermined their profits.

Indonesia's economic reconstruction is under way in accordance with the conditionality of the International Monetary Fund (IMF), in the same way as other countries hit by the currency crisis. The IMF policies comprise macro-economic stabilization policies and economic restructuring policies centering on the reconstruction of the banking and corporate sectors.

Indonesia's reconstruction of the banking and corporate sectors is characterized by the strong leadership being displayed by the Indonesian Bank Restructuring Agency (IBRA, or Badan Penyehatan Perbankan Nasional, BPPN in Indonesian), a government agency. IBRA was established under the jurisdiction of the minister of finance in early 1998 in line with the prescription written out by the IMF. The main tasks of IBRA are to restore banks financial health by taking over their nonperforming loans and to reorganize the banking sector, and to dispose corporate debts to domestic banks transferred to IBRA. This work is the process of post-crisis reconstruction of the banking and corporate sectors as well as the process of dismantling the micro-economic structure formed under the Soeharto regime. That is because the relations between banks and companies and their ownership structure are deeply connected to the structure of vested interests that supported the Soeharto regime.

As of the end of 2001, three and a half years after the collapse of the Soeharto government, the process of dismantling the old system is still under way. Although the post-restructuring shape of the banking and corporate sectors is still far from clear, the resulting structural changes that took place up to the moment are examined below.

### **3.1 Separation of Banks and Business Groups**

The first outcome of IBRA's restructuring efforts is the realignment of the ownership structure of the banking sector. Using the capital adequacy ratio (CAR: the ratio of equity capital to risk-weighted total assets) and the number of customers as the yardsticks, IBRA classified all commercial banks into the three categories: banks to be closed, banks to be restructured, and banks to be allowed to operate as they are. There are two ways of restructuring; capital injection (recapitalization) by the government and nationalization. In the case of capital injection, 80% of capital needed to improve the CAR to 4 % was put up by the government and the remaining 20% by bank shareholders. The government nationalized some major banks whose closures were feared to have the far-reaching impacts and infused capital after merging them into a few banks. All the state-owned banks, which had the lowest CAR, were also injected capital after 4 out of them being merged into one. Irrecoverable loan

**Table 3-1 Change of Ownership Structure of the Banking Sector in Indonesia, 1997 and 1999**  
**— Decline of the Business Group Affiliated Banks —**

Ownership	Before restructuring (1997.6)			After restructuring (1999.12)		
	No. of banks (unit)	Assets (billion Rp.)	% of assets (%)	No. of banks (unit)	Assets (billion Rp.)	% of assets (%)
Government						
	State-owned bank			Total	613,506	78.4
		7	36.9	State-owned bank	365,447	46.7
				Recapitalized bank	93,487	12.0
				Nationalized bank	154,572	19.8
Private						
	Total	263,472	52.0	Total	61,089	7.8
	Business group affiliated <sup>1)</sup>	201,939	39.8	Business group affiliated <sup>1)</sup>	13,522	1.7
	Independent bank	61,533	12.1	Independent bank	47,567	6.1
Foreign						
	Total	42,765	8.4	Total	99,358	12.7
	Foreign bank branch	19,247	3.8	Foreign bank branch	63,186	8.1
	Foreign joint bank	23,517	4.6	Foreign joint bank	36,172	4.6
Regional						
	Regional development bank	13,486	2.7	Regional development bank	8,294	1.1
Total	All commercial banks	506,808	100.0	All commercial banks	782,247	100.0

Notes: 1) Classified by the author based on the names of shareholders of the data source below, CISI Raya Utama, 1000 Major Non-Financial Companies in Indonesia 1999/2000. Jakarta, 1999. Panin bank is classified as independent, since Panin Group centers on the banking industry.

2) Composed of 1 recapitalized bank after merger of 4 banks, 3 recapitalized banks and 1 newly established bank.

3) Composed of 7 private banks (of these, 4 are affiliated with business groups) and 12 regional development banks.

4) 13 private banks (of these, 10 are affiliated with business groups) were nationalized and 9 out of these were merged with others.

5) Represents the number of banks which continued with no measures of restructuring.

Source: Compiled by the author based on PT Ekofin Konsulindo, "Indonesian Banking Indicator and Financial Performance 31 December 1991 - 31 December 1999" (CD-ROM), Jakarta, 2000.

claims (overdue debts over 270 days) of all banks to be restructured were transferred to IBRA to allow them improve their balance sheets. By the time all these procedures were completed at the end of 2000, a total of 67 private banks were closed, 13 banks were nationalized. The government infused capital into a total of 27 banks including 7 private banks, 4 state-owned banks, 4 nationalized banks and 12 regional development banks. The number of banks operating fell from the peak level of 240 at the end of 1996 to 164 at the end of 2000.

Table 3-1 shows how the ownership structure of the banking sector changed through IBRA's bank restructuring. The remarkable development shown in the table is the decline of private banks affiliated with business groups. Immediately before the currency crisis, banks affiliated with business groups numbered 58, accounting for as much as 40% of assets held by all commercial banks. In the private banking sector, they accounted for less than 40% in number but 77% of total assets. Of these business group affiliated banks, 28 were closed, 10 were nationalized, and 4 received the capital injection. Those were allowed to continue operations with no ownership change now account for only 2% of the total assets. Nationalized and recapitalized banks are to be reverted to private banks over time. Government-held equity stakes in the nationalized banks will be sold off to third parties, while the recapitalized banks affiliated with business groups are to be merged again under IBRA's supervision. In either case, these banks will be no longer owned by a single business group.

As a result of the bank restructuring, the asset base of the private banking sector contracted. Also, the integrated ownership structure linking banks to business groups, that formed the foundation of the private banking sector, all but disappeared. The structure was traced back to the establishment of affiliated banks one after another by business groups when the entry barrier into banking business was lifted under the financial liberalization policy of October 1988 (called Pakto). This particular ownership structure caused rampant intra-group lending of group banks to affiliated firms among some major business groups in the 1990s. Ten years after the Pakto, most of business groups lost affiliated banks. Private-sector banks are now categorized mainly into independent banks and banks owned jointly by some business groups. Thus the ownership of banks and business groups was separated.

### **3.2 Reorganization of Indebted Business Groups**

The second outcome of the IBRA policy is the reorganization of some specific business groups that heavily depended on massive lending from the domestic banking sector. During the course of the bank restructuring described above, irrecoverable loans of the recapitalized banks, together with all outstanding loan claims held by the closed banks, were transferred to IBRA. The



Table 3-2 The 21 Largest Obligators from the Domestic Banking Sector, as of Nov.2001

Name of Business Group	Name of Major Owner-Manager	Debt value (trillion Rp.)	No. of debtor companies	% of agreement with IBRA	% of court dispute	Main Business	Sales ranking 1996	Features of owner-manager [C:Chinese, P:priubmi, I:Indian]
1 Texmaco	Marimutu Siniwasan	17.3	17	99.9	-	textile, machinery	28	I close to Soeharto
2 Barito Pacific	Prajogo Pangestu	8.6	18	93.4	-	plywood, chemical	15	C close to Soeharto, Tutut
3 Humpuss	Hutomo Mandala Putra	6.0	19	41.9	54.3	LNG	17	P Soeharto's third son
4 Bob Hasan	Mohamad Hasan	6.2	15	99.7	-	plywood	7	C Soeharto's close friend
5 Bakrie	Abrizal Bakrie	6.1	24	71.0	-	steel pipe	20	P close to Soeharto family
6 PSP	Trijono Gondokusumo	4.2	15	13.0	76.7	real estate	79	C Dharmala's third son
7 Tirtamas	Hashim Djohadikusumo	4.3	12	66.4	29.3	cement, chemical	44	P relative of Soeharto family
8 Napan	Henry Pribadi	3.6	16	92.4	1.1	chemical	47	C co-owner of Salim
9 Tirtobumi	n.a.	2.9	1	-	-	n.a.	-	n.a.
10 Djajanti	Burhan Uray	2.9	8	100.0	-	plywood, fishery	48	C
11 Bimantara	Bambang Trihatmodjo	3.2	10	65.4	19.9	broadcast	6	P Soeharto's second son
12 Raja Garuda Mas	Sukanto Tanoto	2.6	10	96.3	-	paper/pulp	24	C
13 Bahana	(State-owned corp.)	2.9	6	98.8	-	venture capital	-	-
14 Dharmala	Suhargo Gondokusumo	3.0	29	22.8	69.3	trade, real estate	13	C born in Mainland
15 Ongko	Kaharudin Ongko	3.7	19	6.7	81.3	finance, real estate	9	C partly financed by Bob Hasan
16 Gunung Sewu	Dasuki Angkosubroto	3.4	16	89.6	-	real estate	59	C relative of Dharmala
17 Danamon	Usuman Admadjaja	3.1	17	94.3	-	finance, real estate	23	C close to Soeharto, Salim
18 Nugra Santana	Ponco Sutowo	2.2	6	24.2	75.8	real estate	35	P son of former Pertamina president
19 Kodel	Sugen Sarjadh	1.0	4	94.0	-	real estate	109	P co-investment of 8 pribum
20 Rajawali	Peter Sondakh	2.9	11	97.1	-	telecom	43	C
21 Argo Manunggal	The Ning King	2.1	23	100.0	-	textile	12	C many Japanese joint ventures
Total of the 21 largest obligors		91.7	296	74.5	16.6			
( % of total )		(29.5)						
Total of the 50 largest obligors		139.8		58.4	14.0			
( % of total )		(45.0)						
Total corporate debts under IBRA		310.7		32.2	10.4			
		(100.0)						

Source: Compiled by the author base on IBRA, *Monthly Report*, Dec.2001 /IBRA Homepage (<http://www.ibra.go.id>).

total sum of these loans amounted to 256 trillion rupiahs (as of the end of June 2000), or some 50% of all bank loans outstanding in Indonesia, involving some 130,000 debtor companies. IBRA classified debtor companies by shareholder that was called "obligor". It was found that 21 largest obligors (business group owners-managers) listed in Table 3-2 accounted for 30% of the total debts, and 50 largest obligors accounted for 45% of the total debts. Moreover, 8 of the 11 top obligors had close ties with former President Soeharto, including his third son and second son. The eight obligors break down into four pribumi, three ethnic Chinese and one ethnic Indian. These heavily indebted business groups were mostly middle-standing and newly-emerging groups. By lender, state-owned banks accounted for 54% of all loan claims under IBRA.

Thus, it was revealed with statistical evidence that domestic banks in the boom period of the 1990s channeled massive loans to specific business groups. In particular, business group owners with easy access to the center of power in the Soeharto regime obtained large loans without proper screening, particularly from state-owned banks.

These business groups were subjected to intensive debt repayment negotiations with IBRA, coming under heavy pressure to liquidate their assets. IBRA basically seeks debt disposal through such methods as repayment by cash or sale of assets, debt rescheduling, conversion into convertible corporate bonds, and debt equity swap. In dealing with obligors not cooperative in repayment talks, however, IBRA is authorized to file bankruptcy suits, seize assets, or take obligors into debt custody (*lembaga paksa badan*; revival of the legal system during the Dutch East Indies rule under which a creditor can seek a court warrant of imprisonment of a debtor). For example, IBRA brought before court the bulk of debts owed by Ongko Group and PSP Group run by the third son of the founder of Dharmala Group. The founder of Dharmala Group and his eldest son were taken into debt custody, and some of the groups assets were seized. IBRA's work helped dismantle the back-scratching alliance that had been developed through bank loans among the power elite, state-owned banks, specific pribumi and Chinese big businesses during the latter half of the Soeharto era.

### 3.3 Break-up of Chinese Business Groups with Bank Holdings

The third outcome of IBRA's restructuring work was the dissolution of some influential Chinese business groups. In addition to the bank restructuring and disposal of corporate debts, IBRA is charged with another task. The task is to make some bank shareholders repay liquidity support loans that they received from the central bank to cope with bank runs amid the economic crisis. In 1998, the government decided to have 9 shareholders of 8 banks that received the special central bank loans but were later closed or nationalized repay the

loans in full within four years in cash or by sale of assets, and concluded the repayment contracts with the shareholders concerned. These bank shareholders are at the same time the owners-managers of business groups. IBRA forces the shareholders to place assets of their business groups equivalent to the repayment amounts under its control. IBRA then sells the assets off and puts the revenues into the National Treasury as repayments of the central bank loans.

The decision taken by the Habibie government is far harsher than measures to deal with corporate debts owed by the major obligors, which allowed for debt reductions or debt rescheduling. It was based on the thinking that the bank shareholders should repaid the full amounts of the loans to the state within the prescribed period, in exchange for the immunity from prosecution granted for their violations of regulations regarding intra-group lending to affiliate companies. However, apparently lying behind the harsh measure is the fact that Salim Group, the largest business group and also the symbol of ethnic Chinese businessmen with Soeharto connections, was among the nine shareholders.

Table 3-3 lists the nine shareholders of the eight banks subjected to this repayment measure. The central bank loans the nine shareholders had to repay total 113 trillion rupiahs, larger than the total of 92 trillion rupiahs of corporate debts owed by the 21 largest obligors. The shareholders were forced to put under IBRA's control most of the assets of their business groups in the form of shares they held in a total of 228 companies. Of the nine shareholders, seven are ethnic Chinese and two are pribumi. But the two pribumi people are the co-owner-managers of Salim Group since its establishment, and one of them, Sudwikatmono is a nephew of former President Soeharto. In short, all the nine people were involved in the ownership and management of the Chinese business groups. The business groups of Salim, Gajah Tunggal, Ongko and Bob Hasan all were in the top 10 ranking of annual sales before the economic crisis (see Table 3-5). Bank Central Asia (BCA) owned by Salim Group and Bank Danamon owned by Danamon Group were the top private banks, together accounting 25% of the total assets in the private bank sector in June 1997 before the crisis. These influential business groups that formed a part of ethnic Chinese dominant capital that had been accumulated during the Soeharto era not only lost the core bank units but also were broken up to the extent of having no trace of their original form.

Table 3-4 (p. 82) shows how their assets were disposed of. There were a total of 27 cases of asset sales by the end of June 2001, with the 20 cases related to the assets of Salim Group, accounting for as much as 98% of the sale proceeds. Salim Group has the central bank loans to repay far larger than other bank shareholders, amounting to 52 trillion rupiahs, or 47% of the total. The share holdings in 108 companies in the business group were submitted to IBRA for sale. These shares were and being disposed of mainly through (1)

Table 3-3 Banks / Business Groups Subjected to Repayment of Central Bank Loans

Name of private banks subjected to repayment measure	Name of business group	Name of shareholder (owner-manager of business group)	Debt value (trillion Rp.)	No. of companies to be sold off	Name of holding company under the control of IBRA
Bank Central Asia (BCA)	Salim	Soedono Salim	52.6	108	PT. Holdiko Perkasa
Bank Dagang Nasional Indonesia (BDNI)	Gajah Tunggal	Sjamsul Nursalim	28.4	12	PT. Tunas Sepadan Investama
Bank Danamon	Danamon	Usman Admadjaja	12.5	27	PT. Bentala Kartika Abadi
Bank Umum Nasional (BUN)	Ongko	Kaharuddin Ongko	8.3	21	PT. Arya Mustika Mulia Abadi
Bank Umum Nasional (BUN)	Bob Hasan	Mohammad Hasan	5.3	30	PT. Kiani Wildha
Bank Modern	Modern	Samadikun Hartono	2.7	10	PT. Cakrawala Gita Pratama
Bank Surya	Subentra	Sudwikatmono(*)	1.9	6	-
Bank Risjad Salim International (RSI)	Risjadsan	Ibrahim Risjad(*)	0.6	4	-
Bank Hokindo	Hokindo	Hokiarto	0.3	10	PT. Hoswarya Persada
Total			112.6	228	

Note: Two with the mark (\*) are pribumi and co-owner-managers of Salim Group. The rest 7 are the ethnic Chinese.  
Source: Compiled by the author based on IBRA, *Annual Report 2000, Jakarta*.

Table 3-4 Sales of Assets of Bank Shareholders Subjected to Repayment of Central Bank Loans, as of June 2001

Company sold off	Business group	Line of business	Buyer of assets	Sales value		
				Rupiah (bil)	US \$ (mil)	HK \$ (mil)
1 Bank Central Asia (BCA)	Salim	the largest private bank	public (Jakarta stock market)	280	-	-
2 Pacific Indomas Plastic Ind.	Salim	Polystyrene mfg. joint with US	Dow Chemical (US)	-	4	-
3 Indofood Sukses Makmur	Salim	the largest food company	via overseas fund manager, to First Pacific	380	-	-
4 Standard Toyo Polymer	Salim	PVC resin mfg. joint with Japan	Mitsui/Toso (Japan)	-	15	-
5 PT Astra International Tbk.	Salim	holding company of Astra Group	C&C Ltd.(Singapore)	-	389	-
6 BCA building	Salim	headquarter building of BCA	Keppel Land Ltd.(Singapore)	280	-	-
7 PT Karimun Granite	Salim	granite mining	PT Pendawa Sempurna(former owner)	22	-	-
8 PT Danamon Mobil & Pembiayaan	Danamon	automobile finance	n.a.	58	-	-
9 First Pacific	Salim	holding co. for overseas business	public (HK stock market)	-	-	537
10 PT Gatari Air Services	Bob Hasan	chartering aviation services	n.a.	-	3	-
11 PT Indo American Ceramics	Ongko	ceramics mfg.	n.a.	-	6	-
12 Property	Ongko	housing development	n.a.	1	-	-
13 PT Aetna Life Indonesia	Danamon	life insurance	n.a.	12	-	-
14 OAF Ltd.	Salim	core company for overseas business	President of QAF/Qualif (Singapore)	-	-	36
15 Salim Oleochemical Group	Salim	7 companies of palm oil oleochemical	PT Bhakti Investama (Indonesia)	-	127	-
16 Indomilk Group	Salim	2 companies of dairy products mfg.	NV Marison (Netherland)	400	-	-
17 Indomiton	Salim	monosodium glutamate joint with Korea	Daesang (Korea)	-	9	-
18 Mosquito Coil	Salim	5 companies of mosquito coil mfg.	Reckitt Benckiser Plc (UK)	571	-	-
19 Salim Palm Plantation	Salim	25 companies of oil palm plantations	Kumpulan Guthrie (Malaysia)	-	350	-
20 PT Cilicon Griyanugraha	Modern	housing development	n.a.	6	-	-
21 PT Indocoal	Salim	coal mining	PT Centralink Wisesa Int'l (Indonesia)	-	46	-
22 PT Danamon Sanatel	Danamon	telecommunication	n.a.	35	-	-
23 PT Indocement Tunggai Perkasa	Salim/Subentra	the largest cement mfg. company	subsidiary of Heidelberger Zement AG(Germany)	605	44	-
24 First Pacific	Salim	holding co. for overseas business	n.a.	-	-	67
25 PT Indomarco Prismatama	Salim	food and consumer goods distribution	Bhakti Asset Management (Indonesia)	162	-	-
26 PT Kerimas Witkco Makmur	Salim	galvanized sheet mfg.	n.a.	297	-	-
27 PT Indopoly Swakarsa Industries	Salim	plastic sheet mfg.	n.a.	-	29	-
Total				3,109	1,022	537
						103

Source: Compiled from IBRA, *Monthly Report*, July 2001 / IBRA Homepage (<http://www.ibra.go.id>).

Table 3-5 Reorganization of Major Business Groups, as of 2001

Name of business group	Domestic debts (trillion Rp./unit)		External debts estimated value as of end of 1997 (billion US \$)	Restructuring measure for group-affiliated banks	present situations of reorganization
	Unpayable debt from banks	Repayment of central bank loans			
1 Salim	0.6	52.6	(108)	5.5 nationalized	Selling assets to repay central bank loans
2 Astra	0.4	-	-	5.1 capital injection/merger	Rescheduled external debts/capital injection by Japanese JV partners
3 Sinar Mas	0.7	-	-	3.8 capital injection	Selling assets to repay external debts (\$12 bil as of 2000)
4 Gudang Garam	-	-	-	n.a. continue	No problem
5 Lippo	0.6	-	-	3.2 capital injection	
6 Bimantara	* 3.1	-	-	0.5 closed	A part of domestic debt repayment not yet agreed with IBRA
7 Gajah Tunggal	* 1.5	28.4	(12)	3 closed/closed	Selling assets to repay central bank loans
8 Ongko/Bob Hasan	* 2.7	13.7	(51)	n.a. closed/closed	Selling assets to repay central bank loans/bankruptcy suit
9 Djaram	0.2	-	-	n.a. continue	
10 Rodamas	-	-	-	1.05 capital injection/continue	No problem
11 Nusantara/Bob Hasan	* 5.2	-	-	1.7 n.a.	Soeharto's suit dismissed/Bob Hasan found guilty and imprisoned
12 Karbe Farma	0.2	-	-	n.a. closed	Debt custody/regarded as uncooperative by IBRA/bankruptcy suit
13 Dharmala	* 2.7	-	-	0.65 closed/continue	Rescheduled external and domestic debts
14 Argo Manunggal	* 1.9	-	-	3.2 closed	Debt equity swap for a petrochemical project
15 Barito Pacific	* 8.4	-	-	0.45 closed	No problem
16 Maspijon	0.0	-	-	n.a. continue	Debt equity swap for external debts/rescheduled domestic debts
17 Bakrie	* 6.0	-	-	1.5 nationalized	Debits repayment by assets/Tommy arrested
18 Humpuss	* 5.7	-	-	0.4 nationalized	Selling assets to repay central bank loans
19 Danamon	* 3.0	12.5	(27)	1.8 n.a.	No problem
20 Berca	-	-	-	n.a. continue	No problem
21 Panin	0.4	-	-	n.a. closed/nationalized	No problem
22 Jan Darmadi	0.0	-	-	n.a. sold before crisis	No problem
23 Jaya	0.1	-	-	0.35 closed	Rescheduled external debts/closed pulp factory due to environmental problem
24 Sampturna	-	-	-	0.5 closed	Special debt equity swap measure for domestic debts
25 Raja Garuda Mas	* 2.7	-	-	1.5 closed	
26 Texmaco	* 17.3	-	-	n.a. -	
27 Metropolitan	1.2	-	-	n.a. nationalized	
28 Matahari	0.1	-	-	n.a. closed	
29 Ometraco	0.9	-	-	n.a. closed	Selling assets to repay central bank loans/debt equity swap
30 Gemala	0.6	-	-	n.a. closed	Not enabled to continue as a group due to bank industry closed
34 Modern	1.0	2.7	(10)	n.a. closed	A part of assets seized/Tutut investigated
36 Harapan	0.0	-	-	n.a. closed	Debt equity swap for petrochemical project/bankruptcy suit
45 Citra Lamitoro Gung	0.9	-	-	2.0 nationalized/closed	Regarded as uncooperative by IBRA/bankruptcy suit
46 Tirtamas	* 3.9	-	-	n.a. closed	
87 PSP	* 4.9	-	-	n.a. closed	

Note: \* indicates the 21 largest obligors of domestic debts from the banking sector.

Source: Compiled by the author based on IBRA, *Annual Report 2000*, Jakarta/ Kompas and other sources.

sale on the domestic and overseas stock markets; (2) purchases by foreign partners of joint ventures (U.S., Japan, the Netherlands, South Korea, etc.); (3) Asian and European businesses newly entering Indonesia through open bidding (Singapore, Malaysia, and Germany); (4) newly established domestic investment and asset management companies (most of them are partnerships between Indonesian asset managers and foreign investors); and (5) indirect buybacks by Salim (in PT Indofood, the Indonesias largest food company, and QAF Ltd., a Singapore-based core company for the groups overseas businesses). All told, foreign investors are the principal buyers of Salim Group assets being sold off.

Compared with other business groups, the dismantling of Salim Group had several distinct features. First, developments that led to the central bank loans for BCA were highly political. BCA was a top private bank, leading the industry in the number of branches, computerization of operations, information technology, and management capabilities. Still, the bank had to take in the central bank loans because of a major run that started on the following day of the resignation of President Soeharto, triggered apparently by the close ties with Soeharto kept by Liem Sioe Liong, the groups founder, and the fact that Soeharto's eldest daughter and eldest son were among BCA shareholders. Second, strong opposition to the repurchase of group assets by the shareholders was seen particularly for Salim Group. There are no contractual or legal barriers for the groups buyback of assets. But Salim Group had to drop plans to join open tender because its participation was deemed morally problematic by Indonesias parliament, political parties, top officials in IBRA and the central bank. The backlash can be interpreted as a display of pribumi nationalism against the revival of ethnic Chinese conglomerates that flourished during the Soeharto era.

### **3.4 Declining Large Private Capital, Rising State and Foreign Capital**

Table 3-5 (p. 83) shows the reorganization as of 2001 of banks and companies affiliated with the high-ranking business groups before the crisis. The table provides the following four points as aspects of the structural changes.

Firstly, most of the business groups have lost their bank units. Before the reorganization, 28 out of the 35 groups listed in the table had one or more affiliated banks. After the reorganization, only Panin Group and Lippo Group have banking operations as one of their principal businesses. But Lippo Bank, now under the supervision of IBRA as a recapitalized bank, may still lose a group status by government-initiated merger schemes. Gudang Garam Group, Djarum Group and Maspion Group also keep small bank units, but these banks are only peripheral to these groups or to the banking industry as a whole. The separation of business groups and banks can be reaffirmed from the table's data.

Secondly, among the 21 largest obligors heavily depending on domestic bank borrowing, about half can be found in the business groups listed from 6th to 19th place in the table. These groups are under intense pressure for the disposal of their assets. In particular, the position of the Soeharto family businesses is on the decline, including Humpuss Group, which could not stay as a business group after the departure of founder and Soeharto's third son, the second son's Bimantara Group, and Nusamba Group owned by foundations run by Soeharto. Dharmala Group and PSP Group, categorized as uncooperative by IBRA, are finding it difficult to stay in business. Three business groups with big projects of materials and capital goods industry, that is, Barito Pacific Group (holding PT Chandra Asri, an olefin center operator), Texmaco Group (machinery industry), and Tirtamas Group (an olefin aromatic center operator) were accorded the special measures of debt-equity swaps and debt rescheduling under the policy of the Abdurrahman Wahid government to let these businesses continue. But even those three groups are cutting back on other group business operations.

Thirdly, as higher-ranking business groups had higher dependence on overseas borrowing with lower funding costs, the varying degrees of the skill in handling external debt influenced the corporate survival. A good example of success is Astra Group. The group managed to successfully negotiate debt rescheduling and reduction accords with a consortium of foreign creditors. On top of this, the group was able to reorganize its operations and finance through the sale of non-core businesses and the sale of shares to Japanese partners of joint ventures in the core machinery business. On the contrary, Sinar Mas Group with highly competitive export business in paper-pulp and palm oil fell into financial difficulties, after its policy to turn the paper-pulp business into multinational operations using huge external borrowings backfired in the wake of the fall in international prices. Loans to a group paper-pulp company by a group bank that received the capital injection turned sour, bringing in IBRA to dispose of the bad loans. The group eventually is forced to sell off most of its paper-pulp operations through IBRA. Bakrie Group also had to transfer most of profitable businesses into the hands of foreign creditors as a result of debt-equity swaps.

Fourthly, the business groups required to repay the central bank liquidity support loans in full eventually lost a major part of their group businesses.

Through these four major causes, Indonesia's business groups went downhill after they have flowered in the 1990s with uninterrupted growth during the Soeharto era. This represents a major setback for large private capital in the ownership structure of the economy.

The similar trend can be detected in the changes in the ownership structure of listed companies in the Jakarta Stock Exchange Market. Table 3-6 (next page) classifies listed companies into three categories — domestic private, foreign and state-owned companies — by the largest shareholder and



Table 3-6 Change of Ownership Composition of Listed Companies in Indonesia, 1996 and 1999

Ownership classification	No. of companies (unit)		Annual sales (billion Rp.)		Net profits (billion Rp.)		Assets (trillion Rp.)		No. of employees (persons)	
	1996	1999	1996	1999	1996	1999	1996	1999	1996	1999
Domestic private company	184	221	92,958	169,391	8,869	3,336	283	405	578,640	689,480
Foreign company	33	46	12,560	37,659	1,016	-5,157	19	63	60,061	417,148
State-owned company	6	12	13,002	38,412	2,752	-23,092	62	242	53,396	123,758
Total	223	279	118,520	245,461	12,637	-24,913	364	710	692,097	1,230,386
Composition (%)										
Domestic private company	82.5	79.5	78.4	68.8	70.2	-14.8	77.8	56.0	83.6	55.7
Foreign company	14.8	16.4	10.6	15.4	8.0	20.9	5.2	9.1	8.7	34.1
State-owned company	2.7	4.1	11.0	15.8	21.8	93.8	16.9	35.0	7.7	10.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: Classification between domestic private companies and foreign companies depends on whether the largest shareholder is a domestic or foreign investor as of the year studied, not coinciding with the company's legal status based on the investment law, that is, domestic investment company (PMDN) or foreign investment company (PMA).

Source: Calculated from ECFIN, *Indonesian Capital Market Directory*, 1999 and 2000, Jakarta.

compares the ownership composition between 1996 and 1999. The comparison clearly indicates the shift of ownership from private capital to foreign and state capital with the progress of corporate restructuring. The composition of domestic private companies has declined in every indicator, while the composition of foreign companies increased. The composition of assets did not rise significantly for foreign companies, but there were remarkable increases in the composition of sales and of the number of employees. This indicates the rapid advances of foreign companies or growing foreign shareholdings in local private companies, accompanied with improving efficiency of business operations and increasing utilization of low-cost labor. The composition of state-owned companies is also rising, including private banks that were nationalized or recapitalized. The composition rise for state-owned enterprises was conspicuous for assets, but small for sales.

There seem to be two categories of large private businesses that are likely to survive the present challenges. The first category is companies that are totally divorced from the four causes of collapse described above, that is, with less dependence on borrowings from either domestic or external sources and with the less degree of diversification into banking or other businesses. The good example is Gudang Garam Group, the largest clove tobacco maker.

Another category is for companies that overcame the difficulties relying on their own management capabilities, such as Astra Group. Other than Salim Group that went down mainly because of political factors despite its solid management resources, the economic crisis put most business groups to the testing of their management capabilities as corporate organizations. The boom period of the 1990s provided the favorable climate for corporate management, such as expanded opportunities to raise funds from the domestic and international financial markets, expanded chances to set up group banks, growing affiliations of banks and business groups that made fund management easier, and expanded opportunities to acquire business concessions through privatization projects and deepening import substitution. Regardless of ethnic Chinese or pribumi capital, local big businesses that weakened their management capabilities in such a too favorable environment or those which were able to grow even without management capabilities are now being selected on a large scale. In that sense, the major capital realignment through the restructuring of the banking and corporate sectors now being pushed by the government and IBRA goes beyond the dismantling of the structure of alliance between the political power and businesses and also means the selection of businesses on the basis of corporate management capabilities.

#### **4. INSTITUTIONAL REFORM FOR GOOD GOVERNANCE OF GOVERNMENT AND CORPORATIONS**

The purpose of the IMF-led economic restructuring of Indonesia, in a word, is the improvement of the governance of the government and corporations. The IMF believes that the currency crisis in Indonesia collapsed banks and corporations because of the following problems: the rampant practices of KKN (corruption, collusion and nepotism) under the Soeharto regime, or alliances between high political and military officials and businesses; embezzlement of public money by high political and military officials, opaque handling of government off-budget finances, irregular practices of companies, lack of corporate information disclosure and unreliable accounting, banks reckless lending practices and intra-group financing, and the dysfunction of the government's surveillance and supervisory systems.

In line with the IMF policies, revisions to existing laws and enactment of new laws were made, including the central bank law, the bankruptcy law, and the law for the prohibition of monopoly and unhealthy competition. The new central bank law guarantees the central banks independence from the government. But the central banks function of policy-based financing was transferred to respective financial institutions according to policy purposes, and its dysfunctional financial supervision function was handed over to a financial supervision agency that was to be newly created. The first commercial court was established under the revised bankruptcy law. Under the antimonopoly law, the competition surveillance committee was created. After the inauguration of the Abdurrahman Wahid government, apart from the IMF policies, the corruption prevention committee and the commission to investigate assets of public officials were launched, having scholars and NGO representatives as members. Four organizations were created to monitor activities of IBRA, the core entity of economic restructuring that has amassed assets worth over 600 trillion rupiahs under its control. As for corporate governance, the stock exchanges new regulations required all listed companies to have independent commissioners within the Board of Commissioners (*Dewan Komisaris*) and an audit committee headed by the independent commissioner to make regular audit reports to the Board of Commissioners.

Despite the establishment of numerous organizations to monitor activities of the government and corporations, however, cases of corruption and embezzlement are occurring even after the fall of the Soeharto. This indicates that corruption is not just the legacy of the Soeharto authoritarian regime or not limited to specific systems of politics. With the revitalization of political party politics and decentralized local politics, there are signs of KKN practices spreading. Getting rid of the practices of KKN requires the firm political will and the proper function of judicial authorities. As the authorities are said to be sitting at the top of the structure of corruption, the root of this problem

lies deep.

## 5. SUMMARY CONCLUSION AND PROSPECTS

The government of Gen. Soeharto, who ruled Indonesia for 32 years from 1966 through 1998, built the typical authoritarian regime based on developmentalism, becoming the symbol of the era of development in South-east Asia. That regime realized political stability and economic development, enabling sustained economic growth and capital accumulation for the first time in the history of Indonesia. However, the Soeharto regime responded only with the double standards to the international trends of democratization and economic globalization in the 1990s. In other words, the nature of the authoritarian regime did not change at all under its ostensible democratization policy, and crushed bottom-up democratization demands as they crossed the boundaries of the regimes tolerance. The government also embraced the policies of economic liberalization and privatization. In the back of the policies, however, alliance between powerful politicians and specific businesses deepened, as lucrative concessions were granted to a specific business groups, including those of the Soeharto family, over new business entries by private companies and protected areas of import substitution.

The Soeharto government crumbled amid the currency crisis. Indonesia was made to pay for the double standards adopted in responding to the changes in the 1990s; a rapid shift to the democratic political system, and the decline of private businesses that had emerged during the Soeharto era, particularly the dismantling of specific business groups that thronged around the political power for favors. This is where Indonesia is made apart from Thailand and South Korea, both of which democratized their political systems gradually in stages. For reasons of both the economic crisis and the political system change, private businesses in Indonesia suffered the first major setback in the history of development since 1966, which was more intense in magnitude than those experienced by Thai or South Korean counterparts. The ownership structure is undergoing a major change, with private businesses being replaced by state and foreign capital.

For Indonesia, which put an end to the era of development and entered the era of search for a new democratic state system, the analysis of this paper offers three implications for what is going to become of the ongoing corporate restructuring and who will be the main players on the economic scene.

First, a handful of private businesses are beginning to recover from the setback they suffered. What will determine their eventual recovery are corporate capabilities or entrepreneurial capabilities they may have or have not. Necessary capabilities for successful firms include the designing of business and financial restructuring programs, early disposal of debts, organizational

rebuilding and human resource improvement regarding corporate finance and management, and aggressive introduction of foreign capital and know-how.

Second, foreign companies with high expertise in given industry sectors are crucially important as potential buyers of assets held by IBRA and as the key players to shape a recovery of the Indonesian economy. Decisions on the sale of IBRA-held assets directly and indirectly involve many actors; IBRA, a minister in charge, the Financial Sector Policy Committee made up of economic ministers, the President, the parliament, the IMF, and IBRA-monitoring organizations. Parliamentary deliberations more than often reflect the interests of political parties and economic nationalism. The interests of political parties and nationalism occasionally give rise to chauvinism that gives precedence to domestic capital in the purchase of IBRA-held assets. Therefore, in addition to the transparency in the process of the sale of IBRA-held assets, what is important is whether the government can contain the pressure of political interference and make economically rational decisions. This is the issue of the governance of the government.

Third, although so many monitoring and surveillance organizations were established at so many places for the sake of the good governance of the government and corporations, only a limited number of them are likely to function as intended and take root as viable institutions. The economic crisis and the changeover of the political system pushed unfit companies off the stage. However, it remains to be seen how deeply and how extensively the corporate system has undergone substantive change in Indonesia. Similarly, it remains to be seen, with the greatest of caution, whether Indonesia can avoid repeating the bad practices under the Soeharto regime, particularly the KKN practices and the alliance between politics and businesses.